INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	4
Specification of errors to be urged	8
Summary of argument	9
Argument:	
A corporation is taxable with gain where its property is sold to a purchaser, notwithstanding that the property is first distributed to the stockholders who consummate the sale in accordance with a prearranged plan	10
A. The liquidation distribution here was not a genuine transaction which would relieve the corporation from tax. It was a pure formality by which the stockholders acted as conduits to pass title to the purchaser of the corporation's property	10
B. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, is indistinguishable from this case and requires that the sale be imputed to the corporation	22
Conclusion	32

CITATIONS

Cases:

Burnet v. *Commonwealth Imp. Co.*, 287 U. S. 415	15, 28
Burnet v. *Lexington Ice & Coal Co.*, 62 F. 2d 906	14
Commissioner v. *Court Holding Co.*, 324 U. S. 331	9, 11, 13, 14, 16, 17, 21, 22, 23, 24, 25, 26, 27, 28, 30, 32
Fairfield S. S. Corp. v. *Commissioner*, 157 F. 2d 321, certiorari denied, 329 U. S. 774	11
First Nat. Bank of Greeley, Colo. v. *United States*, 86 F. 2d 938	14
Gregory v. *Helvering*, 293 U. S. 465	13, 23, 30, 31
Griffiths v. *Commissioner*, 308 U. S. 355	13, 31
Guinness v. *United States*, 73 F. Supp. 119, certiorari denied, 334 U. S. 819	11
Hellebush v. *Commissioner*, 65 F. 2d 902	14
Higgins v. *Smith*, 308 U. S. 473	31
Howell Turpentine Co. v. *Commissioner*, 162 F. 2d 319	11
Kaufmann v. *Commissioner*, 175 F. 2d 28	11, 28
Minnesota Tea Co. v. *Helvering*, 302 U. S. 609	13, 29, 30
Moline Properties v. *Commissioner*, 319 U. S. 436	15, 28

Cases—Continued

	Page
National Carbide Corp. v. *Commissioner*, 336 U. S. 422	14
Northwest Utilities Securities Corp. v. *Helvering*, 67 F. 2d 619, certiorari denied, 291 U. S. 684	14
Tazewell Electric Light & Power Co. v. *Strother*, 84 F. 2d 327	14
United States v. *Joliet & Chicago R. Co.*, 315 U. S. 44	15, 16, 22
Wichita Term. El. Co. v. *Commissioner*, 162 F. 2d 513	11

Statute:

Internal Revenue Code, Sec. 22 (26 U.S.C. 1946 ed., Sec. 22)	2

Miscellaneous:

Treasury Regulations 45, Art. 547	12
Treasury Regulations 103:	
Sec. 19.22(a)-19	3
Sec. 19.22(a)-21	3, 12

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 214

UNITED STATES OF AMERICA, PETITIONER

v.

CUMBERLAND PUBLIC SERVICE COMPANY, A CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The special findings of fact and opinion of the Court of Claims (R. 55-76), together with the dissenting opinion of Judge Madden (R. 76-77), are reported at 83 F. Supp. 843.

JURISDICTION

The judgment of the Court of Claims was entered on May 2, 1949 (R. 77). A petition for a writ of certiorari was filed on July 28, 1949, and was

granted on October 17, 1949 (R. 78). The jurisdiction of this Court rests on 28 U. S. C., Section 1255 (1).

QUESTION PRESENTED

After it was agreed that the taxpayer corporation's property should be sold to a designated purchaser, and as part of a preconceived plan to avoid the imposition of the tax which would be incurred if the taxpayer sold its property directly to the purchaser, the stockholders caused the taxpayer's property to be distributed to them in a liquidation distribution, and, thereupon, they transferred the property to the purchaser.

The question is whether such a liquidation distribution can be utilized to relieve the corporation from tax where it serves no other purpose than to accomplish a circuitous routing of title from the corporation, through its stockholders, to the predetermined purchaser, all in accordance with a preconceived plan.

STATUTE AND REGULATIONS INVOLVED

INTERNAL REVENUE CODE:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal,

growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.22(a)-19. *Sale of capital assets by corporation.*—If property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale, computed as provided in sections 111 to 113, inclusive. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

Sec. 19.22(a)-21. *Gross income of corporation in liquidation.*—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the

corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and section 19.44-5. (See further section 19.52-2.)

STATEMENT

The following is a summary of the special findings of fact made by the Court of Claims (R. 56-69):

The taxpayer, which was incorporated in 1929, was engaged in the business of generating electricity and distributing it to retail consumers. During the taxable year, all of its capital stock was owned by W. L. McComas and E. S. Mayes, and by members of their immediate families. McComas held certain of these shares in trust for his children. (R. 56.)

Tri-County Electric Membership Corporation, which will be referred to as Tri-County, is a cooperative corporation, organized in 1936, which obtained electrical energy from the Tennessee Valley Authority for distribution. Part of its territory included the area served by the taxpayer. From the time of Tri-County's organization in 1936, it was its plan to acquire the taxpayer's transmission and distribution facilities. Soon after Tri-County began operating, it became evident to

the taxpayer's officers that the taxpayer would have to acquire power from the Tennessee Valley Authority or sell its property to Tri-County, and negotiations to that end continued more or less regularly thereafter. In October, 1939, McComas conferred with a representative of the Tennessee Valley Authority to ascertain whether power could be secured from the Authority or, if not, whether a sale of its properties could be effected. The asking price for all the property was $156,000. (R. 58.) In February, 1940, representatives of the taxpayer met with representatives of the Rural Electrification Administration (called REA), and for several days discussed the possibility of the acquisition by Tri-County of the transmission and distribution lines of the taxpayer. The taxpayer's officers desired to sell the entire plant as a going concern and offered to sell all the stock of the taxpayer to Tri-County for the sum of $156,000. It developed, however, that Tri-County was not interested in buying all of the properties owned by the taxpayer, and desired to purchase only its transmission and distribution lines. Thereupon, the taxpayer's officers offered to sell the stock for $115,000, with the understanding that the other property would be disposed of prior to the sale. The difference between the original price of $156,000 and the reduced price of $115,000 represented the approximate value of the other properties which Tri-County did not desire. The representatives of REA expressed doubts

whether it could finance a purchase by Tri-County of the stock. (R. 59-60.)

It later was made clear that REA could not finance Tri-County's acquisition of the stock. REA offered, however, to finance the acquisition of the desired physical properties at a price of $104,000. (R. 60-61.)

After learning REA's views, the taxpayer's officers employed a firm of certified public accountants to prepare computations of the taxes which would be incurred in various ways of making the sale of the properties desired by Tri-County, that is, by a sale of these properties by the taxpayer, by a sale of the stock by the stockholders, or by dissolution of the company and distribution of the assets to the stockholders who would make the sale. After receiving the computations, taxpayer's officers and legal counsel held a conference for the purpose of considering the tax consequences. As a result of the conference, taxpayer's counsel wrote a letter to a representative of the REA stating that the taxpayer's directors had determined that the taxpayer "will not accept an offer of $104,000.00 for the transmission and distribution lines;" the letter further went on to say that McComas and Mayes "individually" would acquire the properties and would enter into a contract with Tri-County for the sale under certain prescribed conditions. (R. 61-63.)

This offer was accepted by Tri-County, and by a written instrument dated June 10, 1940, McComas

and Mayes agreed to sell, and Tri-County agreed to purchase, the property which was to be acquired by McComas and Mayes from the taxpayer. (R. 64-65.) On August 9, 1940, all the other stock of the taxpayer (except for qualifying shares) was transmitted to McComas and Mayes who were to act as agents for the other shareholders in receiving their distributable portion of the taxpayer's assets. At a special stockholders' meeting, held on August 13, 1940, it was resolved that the corporation should be dissolved and that steps should be taken to liquidate its assets and to distribute to the stockholders, in cash or in kind, the assets not required to pay outstanding debts. On the same day, the board of directors appointed McComas and Mayes as a committee for liquidation, empowered to realize on the assets of the corporation for the payment of its debts and to distribute any remaining assets to the stockholders. (R. 65-67.)

On September 4, 1940, the taxpayer, McComas and Mayes, and Tri-County, filed an application with the Public Service Commission of Kentucky in which it was stated that the taxpayer desired to dissolve, that its transmission and distribution system would be conveyed to McComas and Mayes as a liquidating dividend, and that they desired to sell, and Tri-County desired to purchase, the property. It was also stated that McComas and Mayes would continue operations until the transfer of the property to Tri-County could be completed. The application requested approval of

the proposed dissolution, operation, sale and purchase of the utility properties. The application was granted on September 27, 1940. (R. 67-68.)

On October 22, 1940, the taxpayer, acting through McComas, its president, executed a deed and bill of sale to McComas and Mayes of the properties which Tri-County desired to purchase. By instrument dated October 24, 1940, McComas and Mayes, joined by their wives, conveyed the properties to Tri-County for a consideration of $104,000, with appropriate adjustments to the effective date of sale. (R. 68-69.)

The Commissioner determined deficiencies in the taxpayer's income, declared value, excess profits and defense taxes for the calendar year 1940, resulting, in part, from his determination that the property in question had been sold by the corporation and that the resulting gains should have been included in its taxable income. After the asserted deficiencies had been paid, the taxpayer filed a timely claim for refund with the Commissioner of Internal Revenue. The claim was rejected and the taxpayer instituted proceedings in the Court of Claims for refund. (R. 57-58.) The Court of Claims entered judgment for the taxpayer. (R. 77.)

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred in holding that the taxpayer did not realize taxable gain when its prop-

erty was sold, and in holding that the sale in question was not to be imputed to the taxpayer.

SUMMARY OF ARGUMENT

Where the stockholders of a closely held corporation enter into an agreement to sell the corporation's property to a purchaser, and where the corporation distributes the property to the stockholders in a liquidation distribution for the sole purpose of enabling them to make the sale, the sale and any attendant gains must be imputed to the corporation.

A corporation will not be taxed with gain if it distributes its property in kind to its stockholders in a genuine liquidation distribution. In the present case, however, the liquidation distribution was not intended to make the stockholders the owners of the property. It was used only as a form to cloak a sale of the corporation's property, and was a meaningless step whereby there was a circuitous routing of title to the ultimate purchaser, the stockholders acting as pure conduits. Such a liquidation distribution is not a *bona fide* transaction which will relieve the corporation from tax. This Court so held in *Commissioner* v. *Court Holding Co.*, 324 U. S. 331.

The Court of Claims was wrong in attempting to distinguish the *Court Holding Co.* case on the ground that there the sale negotiations were initiated by the corporation, while here they were commenced by the stockholders. That case did not

turn on the formality of who purports to conduct negotiations. It is bottomed on the proposition that where the liquidation distribution is only an artificial device which serves no legitimate purpose, it cannot alter the tax consequences which would have followed if the corporation had made a direct sale of its property.

ARGUMENT

A Corporation Is Taxable With Gain Where Its Property Is Sold to a Purchaser, Notwithstanding That the Property Is First Distributed to the Stockholders Who Consummate the Sale in Accordance With a Prearranged Plan

A. *The liquidation distribution here was not a genuine transaction which would relieve the corporation from tax. It was a pure formality by which the stockholders acted as conduits to pass title to the purchaser of the corporation's property.*

The issue here is whether a corporation can escape being taxed on corporate gains where its property is sold to a third party, the sale taking place only after the property has first been routed to the stockholders under the guise of a liquidation distribution, and where this is part of a preconceived plan to achieve a sale of the property to the intended purchaser, and yet to avoid the appearance of a direct, taxable sale by the corporation.

The Court of Claims was wrong in holding that, where such a scheme is executed, there can be a

successful evasion of the corporate tax merely because a liquidation distribution, which is one in form alone and is not intended to invest the stockholders with ownership of the property, has been interjected in an attempt to obscure the fact that it is the corporation's property which has been sold to the ultimate purchaser. The decision in *Commissioner* v. *Court Holding Co.*, 324 U. S. 331, where the contrary result was reached under similar circumstances, demonstrates that the court below was in error. So, too, do the other decisions which followed *Court Holding Co.*: *Kaufmann* v. *Commissioner*, 175 F. 2d 28 (C. A. 3d); *Wichita Term. El. Co.* v. *Commissioner*, 162 F. 2d 513 (C. A. 10th); *Guinness* v. *United States*, 73 F. Supp. 119 (C. Cls.), certiorari denied, 334 U. S. 819; *Fairfield S. S. Corp.* v. *Commissioner*, 157 F. 2d 321 (C. A. 2d), certiorari denied, 329 U. S. 774. Contra: *Howell Turpentine Co.* v. *Commissioner*, 162 F. 2d 319 (C. A. 5th).

Normally, of course, a corporation is taxable on any gains realized upon a sale or disposition of its property. A liquidation distribution to the stockholders as a step in making the ultimate sale to the predesignated purchaser has been utilized here, and in other similar situations, because the Treasury regulations have long provided that a corporation does not realize taxable gain or loss when it distributes its property in kind to its shareholders by way of a complete or partial liquidation.

By distributing the property to the stockholders, who then proceed to consummate the sale, the corporation attempts to negate the conclusion that it is the vendor, and to avoid the tax which would be imposed if it had made the sale directly. Such a liquidation distribution, however, is not the kind of a transfer which is tax-free under the Regulations, and it cannot be utilized to insulate the corporation from tax where, instead of making the stockholders the owners of the distributed assets, it is only a means of effectuating a sale of the corporate property to others.

Section 19.22(a)-21, Treasury Regulations 103, *supra*, provides:[1]

> *Gross income of corporation in liquidation.* —When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their

[1] Similar provisions have appeared in all Regulations ever since Article 547, Treasury Regulations 45, promulgated under the Revenue Act of 1918.

acquisition. But see section 44 (d) and section 19.44-5. (See further section 19.52-2.)

The last sentence of this paragraph becomes the focal point of the present controversy. In relieving the corporation from tax when it distributes its property in kind to the stockholders by way of a complete or partial liquidation, this provision of the Regulations, as is true of other provisions of the statute describing non-taxable situations, comprehends genuine transactions; it does not embrace steps which are purely formal in character, which do not have any substantive consequences, and which are utilized solely to disguise one situation so that it has the surface appearance of another. The decisions of this Court have been unvarying in this respect. *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *Griffiths* v. *Commissioner*, 308 U. S. 355; *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609; *Gregory* v. *Helvering*, 293 U. S. 465.

The kind of *bona fide* liquidation distribution which the Regulations describe is one where the corporate assets pass to the stockholders with full and untrammelled ownership, so that the stockholders are thereafter free to deal with the property as their own. The Regulations do not apply where, as here, the liquidation distribution is part of a plan wherein the stockholders will merely act as conduits through whom title can be passed to an intended purchaser. This should be perfectly plain from the preceding portion of the quoted para-

graph which provides that the corporation is taxable, even when its property is sold in the course of dissolution by receivers or trustees who are liquidating the assets. Consistent with this provision of the Regulations, the decisions hold that where a corporation, in the course of liquidation, transfers its property to a trustee or agent who sells the assets, any gain is taxable to the corporation, regardless of whether the trustee purports to act for the stockholders or for the corporation in making the sale.[2]

The Regulations do not embody a self-defeating, internal inconsistency. Since a corporation is taxable in every other situation, regardless of the means by which its property is sold, it was not intended that it should escape the tax whenever the sale is to be made by the stockholders immediately following the receipt by them of the corporate assets in a self-styled liquidation distribution. The contrary is true. A corporation is a separate taxable entity from its stockholders; the corporate income, for tax purposes, cannot be imputed directly to the stockholders, no matter what the devices employed. *National Carbide Corp.* v. *Commissioner*, 336 U. S. 422; *Commissioner* v. *Court Holding Co.*,

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[2] *First Nat. Bank of Greeley, Colo.* v. *United States*, 86 F. 2d 938 (C.A. 10th); *Tazewell Electric Light & Power Co.* v. *Strother*, 84 F. 2d 327 (C.A. 4th); *Northwest Utilities Securities Corp.* v. *Helvering*, 67 F. 2d 619 (C.A. 8th), certiorari denied, 291 U.S. 684; *Hellebush* v. *Commissioner*, 65 F. 2d 902 (C.A. 6th); *Burnet* v. *Lexington Ice & Coal Co.*, 62 F. 2d 906 (C.A. 4th).

324 U. S. 331; *Moline Properties* v. *Commissioner*, 319 U. S. 436; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415. As seen above, this is as true when the corporate property is sold during dissolution as it is during the time when the corporation is actively engaged in business.

In *United States* v. *Joliet & Chicago R. Co.*, *supra*, all of the corporation's property was transferred to another company under a "perpetual lease," the transferee undertaking to make annual payments directly to the stockholders of the transferor. It was held that the payments were nevertheless taxable to the transferor corporation, the opinion stating (pp. 48-49):

> Payments made directly to shareholders by the lessee or transferee of corporate property are properly recognized as income to the corporation by reason of the relationship of a corporation to its shareholders. * * *
>
> The relationship between respondent and its shareholders is an abiding one. They obtain the dividend payments because of their status as shareholders. All questions of the rights of creditors aside, there can be no doubt that a corporation may normally distribute its assets among its stockholders. When it undertakes to do so, its act is nonetheless a corporate act though its shareholders receive new contractual rights enforceable by them alone against the transferee. That is to say, their rights to receive the proceeds on the dis-

> posal of corporate assets are strictly derivative in origin. * * * The fact that the corporation may remain in existence only to maintain a stock transfer book is immaterial. The umbilical cord between it and its shareholders has not been cut. * * *

Paraphrasing the *Joliet* case here, the fact that the transfer of the corporation's property may have given the stockholders new contractual rights, enforceable by them against the transferee, does not avoid the tax on the corporation. The stockholders receive these new rights through the corporation because they are the stockholders and, the "umbilical cord" between the corporation and its stockholders being unsevered, the income must first flow into the corporation before it can pass to the stockholders.

The formalism of a liquidation distribution cannot be successfully used to deflect the corporate gains to the stockholders. In the *Court Holding Co.* case, *supra*, as here, the corporation attempted to avoid the tax by making such a distribution to the stockholders, who, in turn, proceeded to consummate the sale as individuals; this Court, in upholding the Tax Court, which had held the corporation taxable, said (324 U. S. at 334):

> The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commence-

> ment of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

That the liquidation distribution in this case, as in *Court Holding*, was not the kind of genuine transaction which would make the stockholders the new owners of the property, and which would relieve the corporation from tax, is made clear by an analysis of the undisputed facts. Here, a written agreement to sell the corporate property to a purchaser was reached while the corporation was still the owner and the only taxable entity capable of making a sale. Here, the liquidation distribution was conceived as a method of avoiding the normal incidence of the tax, and was utilized only so that the stockholders would be momentary repositories of title, obligated to transfer the property to the predesignated purchaser immediately. The liquidation distribution was only a step in an integrated plan to accomplish, somewhat deviously, the desired end, namely, the transfer to the intended purchaser. It was a meaningless gesture, except as it sought to achieve a different tax result and to place a different complexion on what would have been the situation if the passage of title had taken a less cir-

cuitous route from the corporation to the purchaser. In view of the uniform decisions of this Court, it represented an unwarranted confidence that formalistic ritual would prevail over the substantive situation.

The stock of the taxpayer corporation was owned by two individuals, W. L. McComas and E. S. Mayes, and by members of their immediate families. (R. 56.) They had attempted to sell their stock to Tri-County Electric Membership Corporation. (R. 58-59.) Because the REA would not finance a sale of stock to Tri-County, it became plain that only the physical properties owned by the taxpayer could be the subject matter of the sale. On May 15, 1940, a representative of the REA made an offer to finance a sale of the physical properties which Tri-County desired to acquire, at a price of $104,000. (R. 61.) The taxpayer's officers thereupon employed an accounting firm to compute the tax consequences which would ensue: (a) if a sale of the properties were made by the taxpayer, or (b) if the stockholders sold their stock, or (c) if the taxpayer dissolved and distributed its assets to the stockholders who would subsequently make the sale. (R. 61-62.) After receiving the computations, the taxpayer's officers and its legal counsel held a conference to consider the various tax consequences. Thereafter, the taxpayer's counsel advised the REA that the taxpayer would not accept the offer, but that McComas and Mayes, "as individuals," would acquire

the property from the taxpayer and would agree to sell it to Tri-County for $104,000. (R. 62-64.)

This offer, which was made on May 31, 1940, was accepted by Tri-County, and was embodied in a written agreement dated June 10, 1940, wherein McComas and Mayes agreed to sell, and Tri-County agreed to purchase, certain described facilities of the taxpayer, the sale price being $104,000. (R. 64-65.)

At a special stockholders' meeting, held on August 13, 1940, it was resolved that the corporation should be dissolved and that steps should be taken to liquidate its assets and distribute to the stockholders in cash or in kind the assets not required to pay outstanding debts. On the same day, the board of directors appointed McComas and Mayes as a committee for liquidation, empowered to realize on the assets of the corporation for the payment of its debts and to distribute any remaining assets to the stockholders. (R. 65-67.)

On September 4, 1940, the taxpayer, McComas and Mayes, and Tri-County, filed an application with the Public Service Commission of Kentucky in which it was stated that the taxpayer desired to dissolve, that its transmission and distribution system would be conveyed to McComas and Mayes as a liquidating dividend, and that they desired to sell and Tri-County desired to purchase the property. It was also stated that McComas and Mayes would continue operations until the transfer to Tri-

County could be completed. It requested approval of the proposed dissolution, operation, sale and purchase of the utility properties. The application was granted on September 27, 1940. (R. 67-68.)

On October 22, 1940, the taxpayer, acting through McComas, its president, executed a deed and bill of sale to McComas and Mayes of the properties which Tri-County desired to purchase. By an instrument dated October 24, 1940, McComas and Mayes conveyed the properties to Tri-County for a consideration of $104,000. (R. 68-69.)

These matters, we submit, conclusively demonstrate that the sale must be imputed to the corporate taxpayer and that there was no *bona fide* liquidation distribution which would relieve it from being taxed. Once it became clear that the stockholders could not sell their shares of stock to Tri-County, it was inevitable, if any sale was to be made, that it was the corporation's property which would have to be sold. The only reason why the corporation refused to make a direct sale to Tri-County, as would have been the more normal procedure, is that the stockholders entertained the pious hope that the normal tax consequences could be avoided by a more elaborate procedure.

Beginning with the offer of May 31, 1940, to the very end, it was clear that the liquidation distribution was to take place only so that the stockholders would immediately sell the property to Tri-County. The offer and the contract of sale, both of which

were made while the corporation still owned the property, and the sequence of events wherein the sale to Tri-County followed by two days the distribution to the stockholders, could speak no more plainly. Indeed, the application to the Public Service Commission, which was made by all the parties, including the taxpayer, and which was required to be approved before any of the steps could be taken, establishes beyond dispute that the stockholders were to retain the property no longer than it would take to consummate the transfer to Tri-County. Ultimate ownership was to be acquired by Tri-County, not by the stockholders.

The added factor of the liquidation distribution served no other purpose than to have the transfer of title take a course more devious than would have been true of a direct sale by the taxpayer to Tri-County. Such a circuitous routing of title, however, cannot disguise the fact that it was intended all along that the corporation's property was to be sold to Tri-County and that the stockholders were not to become the true owners of the property. It cannot deflect the tax consequences from the corporation. Even though the proceeds of sale were paid directly to the stockholders, the situation is the same as though the corporation, through its agents, had sold the property in the course of dissolution, had collected the money, and distributed the cash to the stockholders on liquidation. *Commissioner* v. *Court Holding Co.,* 324 U. S. 331. Cf.

United States v. *Joliet & Chicago R. Co.*, 315 U. S. 44. See also the cases cited in footnote 2, p. 14, *supra*.

B. *Commissioner* v. *Court Holding Co., 324 U. S. 331, is indistinguishable from this case and requires that the sale be imputed to the corporation*

Commissioner v. *Court Holding Co.*, 324 U. S. 331, is conclusive that the Court of Claims erred in this case. There, the corporation had started negotiations to sell all of its property, consisting of an apartment building. After an oral agreement had been reached, it was decided that the corporation would not sell because of the tax consequences. Instead, the property was distributed to the stockholders by way of a "liquidating dividend," and the stockholders then sold the property to the same purchaser on substantially the same terms as had previously been agreed upon. In holding that the Tax Court was warranted in attributing the sale to the corporation, this Court, as we have already noted (pp. 16-17, *supra*) said that the sale by the corporation could not be transferred into a sale by the stockholders merely because they were used (p. 334) "as a conduit through which to pass title." The formalism of a liquidation distribution could not, the opinion observed, be used to disguise the true nature of the transaction.

The Court of Claims, however, attempted to dis-

tinguish the *Court Holding Co.* case on grounds so infirm that, if accepted, they would completely undermine the substantial principles on which that decision actually rested. It thought that the result there turned on the fact that the corporation, as such, had started the negotiations which were dropped to avoid the tax consequences, and that, while the sale was "nominally made by the stockholders," yet "the corporation, having initiated the sale, in effect consummated it." (R. 75.) The court below believed that *Court Holding Co.* (R. 75) "* * * did not hold that the stockholders could not have initiated negotiations for the sale in the first instance, and could not have carried it through themselves without resulting liability on the corporation for any profit derived from the sale." The guiding principle to be applied, the Court of Claims observed, was the legal right of a taxpayer to decrease his taxes by any means permitted by law. (R. 74-76.)

We subscribe to the last mentioned principle wholeheartedly. "But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended." *Gregory* v. *Helvering,* 293 U. S. 465, 469.[3] In the

[3] A bona fide liquidation distribution, of the kind contemplated by the Regulations, can take place even though the motivating considerations spring from tax consequences. For example, in the case of a closely held or a "one man" corporation, it may be decided that there are tax disadvantages in having the business continue in a corporate form and that there would be a tax advantage in having the business operate as a partnership, or under a sole proprietorship.

context of this case, the crucial question, which the Court of Claims failed to meet, is whether the pure formalism of a liquidation distribution is one of the means permitted by law to decrease the corporation's tax. *Court Holding Co.* demonstrates that it is not. There can be no doubt that a liquidation distribution took place there, and that there the stockholders, not the corporation, were the formal vendors. If a purely formal liquidation distribution is a legitimate means of avoiding the corporate tax, there is no reason why it should not have been available for that purpose in *Court Holding Co.* A legitimate means for decreasing tax liability, so long as it is actually utilized, should be no less legitimate because executed at one period of time rather than another.

The faulty analysis of the court below lies in the failure to appreciate that the crux of the *Court Holding Co.* decision was that the liquidation distribution in that case was not a *bona fide* one. Because the sale to the purchaser followed immediately after the liquidation distribution, the Tax Court drew a warranted inference that the stockholders were never intended to become the owners of

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A liquidation distribution by the corporation of all its assets to the stockholders who thereupon utilize them in a partnership, or to the sole stockholder who uses them in a sole proprietorship, would be covered by the Regulations where that is the purpose of the distribution, and no gain would be imputed to the corporation. In those circumstances, the stockholders receive the assets as owners. If the stockholders, thereafter, as an independent matter, and not as part of a preconceived plan, sell the assets, there is no reason to impute the gain to the corporation.

the property, and that the distribution was merely a formalism through which a circuitous routing of title took place. Accordingly, the Tax Court there was on firm ground in concluding that there was no provision of law which could relieve the corporation from being taxed on the gains which inhered in the corporate property, and that the sale was required to be imputed to it.

This case is actually an *a fortiori* situation. In *Court Holding Co.*, the inferences respecting the genuineness of the liquidation distribution were drawn from the sequence of events. In the present case, the underlying facts would not warrant an inference that the liquidation distribution was a genuine one. Here, as we have seen, the parties always made it crystal clear that the stockholders were never to retain ownership of the property. Indeed, the Court of Claims did not find otherwise. In these circumstances, as a matter of law, the liquidation distribution cannot serve to relieve the corporation from tax and it must be taxed with the gains which were realized when its property was sold.[4]

[4] In some circumstances, of course, the ultimate facts might not be clear. That is, conflicting inferences might be drawn from the underlying facts as to whether the liquidation distribution was intended to make the stockholders the owners of the property, free to do with it as they please. In such cases, of course, the function of drawing the requisite inferences is within the traditional province of the fact finders.

Where the fact finders have drawn a legitimate inference from different underlying facts to the effect that the liquidation distribution was not one intended to make the stock-

The Court of Claims, accordingly, was altogether wrong in attempting to distinguish *Court Holding Co.* on the ground that there the sale was imputed to the corporation because it had started the negotiations for the sale of its property, and in thinking that a contrary result was required here where the stockholders initiated the bargain to sell the corporation's property. The *Court Holding Co.* case, in searching for the "substance" of the transaction, and in looking to the "whole" rather than to "each step" of what was done, and in refusing to permit the purpose of the statute to be subverted by "mere formalisms," certainly did not make the taxable consequences turn on the capacity in which the officers or stockholders purport to act, or on whether the corporation, as here, has meticulously avoided the appearance of being a party to the transaction. The stockholders in the *Court Holding Co.* case became aware of the tax consequences only after they had disclosed their purpose by the preliminary steps taken, and were unsuccessful in their later attempts at disguise. However, as Judge Madden pointed out in his dissenting opinion below (R. 77), the taxing statute does not require a different result where, as here, the stock-

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holders the owners of the property, and where, in harmony with the *Court Holding Co.* case, it was decided that the corporation could not escape being taxed, we have, quite properly, opposed further review by this Court. The critical comments in the taxpayer's brief in opposition with respect to the Government's position (pp. 6-7) are totally without warrant.

holders are cognizant of the tax consequences in advance. The substance of the situation here is not altered by the fact that the parties, unlike the stockholders in *Court Holding Co.*, were able to prepare the ritual before any part of the ceremony had started. Actually, as we have seen, the stockholders here disclosed the ultimate goal even more clearly than was done in the *Court Holding Co.* case.

If the decision below possessed validity in holding that the stockholders can initiate negotiations to sell the corporation's property and can carry it through themselves (R. 75) "without resulting liability on the corporation for any profit derived from its sale", no corporation need ever be taxable during dissolution, contrary to the express provisions of the Regulations. All that would be required is that, instead of being transferred to liquidating agents who act for the corporation, the property be transferred, on paper, to the stockholders as a liquidation distribution, and that the selling authorities be called "agents of the stockholders" instead of "agents of the corporation." The *Court Holding Co.* decision, we firmly believe, did not invite the use of liquidation distributions as devices for tax avoidance when part of a preconceived plan to sell the corporate property, and did not encourage an added formalism of pretending that the corporation's officers or agents act for the stockholders when dealing with the corporation's property. This seems particularly true where, as here, the officers and stock-

holders are the same individuals.[5] In this connection, in the indistinguishable circumstances presented in *Kaufman* v. *Commissioner*, 175 F. 2d 28, 30-31 (C.A. 3d), the court properly pointed out that the officers and directors of a corporation have a legal duty to deal with the corporate property for the benefit of the corporation, and not for their own advantage, and that this is as true of a closely held corporation as of any other. It observed (p. 31), as this Court has repeatedly held, that stockholders "may not wholly ignore their corporate responsibilities merely because it suits them better for tax or other purposes to act as proprietors rather than as fiduciaries." See also *Moline Properties* v. *Commissioner*, 319 U. S. 436; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415.

In requiring that the meaningless step of the liquidation distribution be disregarded in the *Court Holding Co.* case, the decision there was not peculiar to corporate dissolutions. It was, on the contrary, applying the solid principles an-

[5] The artificiality of pretending that the parties can select the capacity in which they will act is exemplified by the fact that, while the sale to Tri-County was purportedly made on behalf of the stockholders, there were other assets which remained and which McComas and Mayes purportedly sold on behalf of the corporation. Some of this property they sold to themselves and, interestingly enough, the corporation claimed that it suffered a loss on the sale. (R. 69-71.)

Because of its decision on the issue which is on review, the Court of Claims never reached the question whether deductible losses were sustained. (R. 76.) If this Court upholds the contentions of the United States with respect to the issue on review, the case should be remanded to the Court of Claims to enable it to pass on this further question.

nounced in earlier decisions which were cited (324 U. S. 331, 334, fn. 4). Thus, the similarity between the tax-free provisions which the taxpayer attempted to invoke in *Minnesota Tea Co.* v. *Helvering*, 302 U. S. 609, and those which are involved here, is quite apparent. Here, as there, the fact that there has been a formal compliance with the words of the statute is not sufficient. In the *Minnesota Tea Co.* case, the corporation would have been relieved by statute from tax on its gains to the extent that cash received by it in a "reorganization" was distributed by it in pursuance of the plan of reorganization. To the extent that the cash was not so distributed, the gain was taxable to it. The cash was actually distributed to the corporation's stockholders, but they were required to use it to pay certain debts of the corporation. The Court held that the statute contemplated a distribution to the stockholders and not a payment to the corporation's creditors, even though it was first routed through the stockholders.

Although the tax exemption provisions involved there and here are different, both contemplate a distribution to the stockholders—not one which is purely ritualistic and which is part of an integrated plan to cause the property to come to rest in someone to whom a direct transfer would be outside the purpose of the relief provisions. To accept the ritualism and to overlook the end result accomplished, as the Court of Claims and the taxpayer

would do, is to subvert the purposes for which the exemption was created. The language of the Court in the *Minnesota Tea Co.* case (pp. 613-614) is singularly apt here:

> Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different result because reached by following a devious path. *The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the fund to the creditors, all along intended to come to their hands, so transparently artificial that further discussion would be a needless waste of time. The relation of the stockholders to the matter was that of a mere conduit.* The controlling principle will be found in *Gregory* v. *Helvering*, 293 U. S. 465, 469-470; * * *. (Italics supplied.)

Gregory v. *Helvering*, 293 U. S. 465, also cited in *Court Holding Co.*, similarly demonstrates how formal compliance with the words of the statute is not sufficient when merely utilized to disguise the substantive nature of the transaction. There, the taxpayer's wholly owned corporation transferred securities to a new corporation, organized to avoid taxes, which issued all its shares to the taxpayer, and which was subsequently dissolved and liquidated by the distribution of the securities to

the taxpayer. It was held that, although the transaction had the form of a corporate reorganization, it was without any business purpose and, consequently, the non-recognition provisions of the income tax law were inapplicable. This Court, examining the substance of the situation, concluded that the corporation was nothing more than a contrivance (pp. 469-470)—

> having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. * * *
>
> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

Griffiths v. *Commissioner*, 308 U. S. 355, and *Higgins* v. *Smith*, 308 U. S. 473, which were also

relied on in *Court Holding Co.*, likewise illustrate the application of this sound, fundamental principle, and demonstrate the broad grounds on which that case was decided. The decision below and the artificial facts on which it was decided, make a mockery of the *Court Holding Co.* case and the decisions which it applied.

CONCLUSION

The decision below should be reversed and the case remanded to the Court of Claims to enable it to decide an additional issue not passed on below.

Respectfully submitted,

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